

Economic Commentary



Market Commentary for March 2009

Nearing a Bottom?

The United States economy remains in its worst condition since the Great Depression of the 1930s. Preliminary figures from the Bureau of Economic Analysis for gross domestic product (GDP) growth for the first quarter of 2009 were not yet released as of this writing, but many economists are predicting a contraction of around 5 percent. Some more optimistic sources are predicting only a 1 to 2 percent fall in GDP. The final figure for the fourth quarter of 2008 was revised slightly downward from negative 6.2 percent to negative 6.3 percent. The problems with the economy are broad-based, including a banking crisis, massive job losses, and the collapse of the housing market. The government has taken steps to ease the economic pain, such as the nearly \$1 trillion stimulus package passed in February, an expansionary monetary policy, and a new program to help the banks with their problematic balance sheets.

The employment situation got worse in March. Non-farm payrolls declined by 663,000 and the unemployment rate rose to 8.5 percent from 8.1 percent in February. Virtually all sectors of the job market were affected, with manufacturing and construction taking the biggest hits. If workers who are employed part-time involuntarily are included, the unemployment rate is 15.6 percent. The unemployment rate is expected to continue to rise until early 2010 when a slow rebound is expected to begin.

The consumer continues to have a bleak outlook, but it may be bottoming out instead of worsening. The Conference Board's index of consumer confidence actually rose slightly in March to 26.0 from 25.3, although it is still at near-historic lows. The expectations component of the index rose 1.6 points while the present conditions component fell 0.8 points. This suggests that consumers' attitudes about the future are slightly more optimistic than they are about the present. Likewise, the University of Michigan Consumer Sentiment Survey also rose 1.0 point to 57.3 in March, with a similar split between the expectations and current conditions components. Personal income fell 0.2 percent in February. Real spending also dropped 0.2 percent, after an upwardly revision of 0.7 percent in January. The savings rate fell slightly in February to 4.2 percent from 4.4 percent the previous month. The top line urban consumer price index (CPI) rose 0.4 percent in

February from the previous month. Core CPI year-over-year rose 1.8 percent, meaning that inflation remains low.

Huge challenges remain on the business front. Corporate profits plummeted at the annualized rate of \$250 billion in the fourth quarter of 2008, which is the biggest drop in history. However, in February, durable goods orders climbed 3.4 percent, which is the first rise since July of last year. The Institute for Supply Management's manufacturing index, which measures the overall health of U.S. manufacturing, also saw a modest increase from 35.8 to 36.8 in March and is showing signs of stabilizing, however it still remains at a depressed level. In all, a bottom may be forming for manufacturing.

There is some hope in the housing sector. Existing home sales rose in February 5.1 percent month-over-month, which makes for the strongest gain since July 2003. It appears the gain was not a regional phenomenon and indeed occurred broadly across the country. In addition, house prices declined at a slower rate in February, 15.5 percent year-over-year as opposed to 17 percent in January. New home sales were up too by 4.7 percent in February. Although it is too early to say definitively if these indicators suggest that the housing market too may be nearing a bottom.

The Federal Open Market Committee (FOMC) met on March 17 and announced it will continue to keep the fed funds target rate between zero and 0.25 percent. In addition, the Fed unveiled further measures to help the ailing economy. In a statement released the Fed announced, "To provide greater support to mortgage lending and housing markets, the Committee decided today to increase the size of the Federal Reserve's balance sheet further by purchasing up to an additional \$750 billion of agency mortgage-backed securities, bringing its total purchases of these securities to up to \$1.25 trillion this year, and to increase its purchases of agency debt this year by up to \$100 billion to a total of up to \$200 billion. Moreover, to help improve conditions in private credit markets, the Committee decided to purchase up to \$300 billion of longer-term Treasury securities over the next six months." The Fed hopes that with these aggressive actions, the economy will begin to expand again at the end of 2009.

Sector Review

U.S. Treasuries: The Treasury market rallied across the yield curve in March in part due to the Federal Reserve announcing a new program to buy up to \$300 billion of Treasuries from the market and increasing their purchases of mortgage-backed securities by another \$750 million. The Fed also reiterated that it plans on keeping rates low for "some time." The 10-year note yield declined to a 2.66 percent yield from a 3.01 percent yield over the prior month. The two-year note yield slid to a 0.80 percent yield from a 0.97 percent yield while the three-month bill saw yields decrease from a 0.24 percent to a 0.20 percent. (Rates and prices maintain an inverse relationship. Prices decrease as yields increase).

Commercial Paper: Changes may be coming shortly to the guidelines surrounding money market funds. The Group of Thirty (G - 30), the Investment Company Institute (ICI), and U.S. Treasury Secretary Timothy Geithner have all commented on potential improvements to help address liquidity and credit standards for money market funds in order to help avert illiquidity concerns that befell many funds during the credit crisis. Increased regulator scrutiny, reductions of the exposures to credit risk, and greater portfolio transparency are among the adjustments being discussed to help shore up industry practices. One-month, top-tier, higher quality asset-backed commercial paper (ABCP) names continued to trade between

0.55 percent and 1.25 percent and three-month paper traded between 0.45 percent and 1.50 percent.

U.S. Government Agencies: The Federal Open Market Committee (FOMC) also announced that it would try and target an additional \$100 billion of agency coupon debt purchases along with targeting \$750 billion of additional agency mortgage-backed securities. This support could total up to \$1.25 billion when the program is completed. Agency yields at month-end on three-month paper yielded near 0.20 percent, six-month paper yielded 0.44 percent, and 12-month paper yielded 0.65 percent.

Strategy: The Federal Reserve continued to maintain its federal funds target range between 0.00 and 0.25 percent. The rapid deterioration of labor market conditions and the decline in consumer spending, business investment, and industrial production remain a source of concern for the Federal Reserve and continue to create challenges for all asset managers. We remain very defensive regarding our strategy by attempting to maintain ample cash while also being very selective in identifying and implementing trade opportunities to add yield available in the longer part of the money market curve.

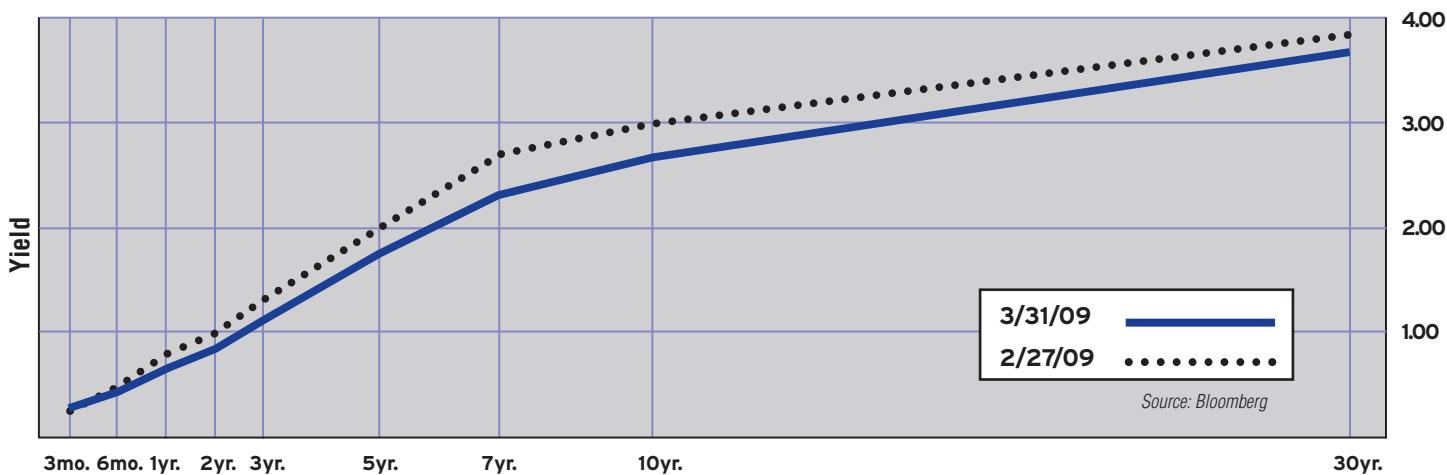


Market Summary for March 2009

Monthly Market Summary - Week-ending Rates and Yields

	03/06	03/13	03/20	03/27	1st QTR AVG
Overnight Rates					
Effective Fed Funds	0.20	0.15	0.18	0.15	0.18
Repurchase Agreements	0.20	0.05	0.15	0.10	0.16
Discount Rates					
1 Month Treasury Bill	0.11	0.09	0.09	0.03	0.10
1 Month Agency Disc.	0.20	0.18	0.13	0.07	0.17
1 Month Com'l Paper	0.46	0.38	0.39	0.31	0.36
3 Month Treasury Bill	0.19	0.18	0.19	0.16	0.18
3 Month Agency Disc.	0.34	0.31	0.24	0.20	0.30
3 Month Com'l Paper	0.82	0.70	0.67	0.67	0.71
6 Month Treasury Bill	0.38	0.38	0.35	0.36	0.33
6 Month Agency Disc.	0.54	0.50	0.38	0.38	0.47
6 Month Com'l Paper	1.08	1.01	0.92	0.86	1.04
Yields					
1 Year Treasury	0.67	0.67	0.60	0.58	0.56
1 Year Agency	0.81	0.75	0.61	1.03	0.76
2 Year Treasury	0.95	0.96	0.87	0.91	0.90
2 Year Agency	1.69	1.77	1.63	1.62	1.60
5 Year Treasury	1.88	1.87	1.64	1.80	1.77
5 Year Agency	2.70	2.75	2.56	2.63	2.65

Historical Yield Curve



Key Economic Indicators

	For the Period	Date of Release	Expected	Actual	Prior
Unemployment Rate	March	04/03	8.5%	8.5%	8.1%
Consumer Price Index	February	03/18	0.0%	0.2%	0.0%
- Less Food and Energy	February	03/18	1.7%	1.8%	1.7%
Consumer Conf. (CB)	March	03/31	28.0	26.0	25.0
FOMC Rate Decision		03/18	0%-0.25%	0%-0.25%	0%-0.25%
Gross Domestic Product	4QF	03/26	-6.6%	-6.3%	-6.2%

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